DEPARTMENT OF STATE REVENUE

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Letter of Findings: 04-20110121
Sales and Use Tax
For the Years 2007, 2008, and 2009

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ISSUE

I. Sales and Use Tax – Imposition.

Authority: IC § 6-2.5-1-1 et seq.; IC § 6-2.5-2-1; IC § 6-2.5-4-1; IC § 6-2.5-5-1 et seq.; IC § 6-8.1-3-12; IC § 6-8.1-5-1; 45 IAC 2.2-3-7; 45 IAC 2.2-3-10; 45 IAC 2.2-4-1; 45 IAC 2.2-4-2; 45 IAC 2.2-4-21; 45 IAC 2.2-4-26; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't of State Revenue v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); Ind. Dep't of State Revenue v. Trump Ind., 814 N.E.2d 1017 (Ind. 2004); Sales Tax Information Bulletin 60 (July 2006).

Taxpayer protests the assessments on "trip charges" and sales of certain tangible personal property.

STATEMENT OF FACTS

Taxpayer is an Indiana company which sells, installs, maintains, and services heating and cooling equipment both for commercial and residential customers. The Indiana Department of Revenue ("Department") conducted a sales/use tax audit for tax years 2007, 2008, and 2009 (the "Years at Issue").

Due to the volume of Taxpayer's records, the audit utilized two different approaches in examining Taxpayer's accounts and records. To determine Taxpayer's sales tax liabilities for the Years at Issue, the Department utilized a sample selected from Taxpayer's 2009 sales records and a projection method. To determine Taxpayer's use tax liabilities, the Department reviewed "all 2008 purchase invoices" to compute an error rate and then applied the error rate to the Years at Issue.

Pursuant to the audit, the Department determined that Taxpayer failed to collect and remit sales tax on certain transactions in which Taxpayer transferred tangible personal property to its customers. The Department's audit also assessed use tax on the grounds that Taxpayer did not pay sales tax or self-assess and remit the use tax on certain purchases of tangible personal property, which Taxpayer used for its business.

Taxpayer only disagreed and timely protested the assessments of sales tax on "trip charges" and sales of certain tangible personal property listed within the sample population. A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales and Use Tax – Imposition.

DISCUSSION

During the audit period and pursuant to IC § 6-8.1-3-12(b), the Department utilized statistical sampling to determine Taxpayer's sales tax liabilities for the Years at Issue. Upon reviewing Taxpayer's sample invoices, the Department determined that Taxpayer sold certain tangible personal property but did not collect sales tax at the time of the transactions. Additionally, the Department determined that many of Taxpayer's invoices included a line item labeled "trip charge" which was a part of the consideration for the sale of tangible personal property, and, as a result, the audit also assessed sales tax on the "trip charge."

Taxpayer, to the contrary, first claimed that the Department's audit erroneously assessed sales tax on "trip charges," which were non-taxable services. Taxpayer also asserted that certain retail transactions were exempt from sales tax because they qualified for "improvement of realty" and it charged the customers on a "lump sum" basis; therefore, it was not responsible for collecting and remitting the sales tax since Taxpayer paid the sales/use tax on the materials at the time of the purchases.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). There are exemptions available for sales tax. IC § 6-2.5-5-1 et seq. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." Id. at 100-101.

A. Unitary Transaction.

The Department assessed Taxpayer additional sales tax because Taxpayer failed to collect the sales tax on certain tangible personal property which it sold to its customers, including, but not limited to, filters, water panels, capacitors, igniters, compressor, condenser pumps, inducer motors, humidifiers, transformers, coil cleaners, and

blower motors (the "Items at Issue").

Taxpayer, to the contrary, asserted that its sales of the Items at Issue were exempt from sales tax. Specifically, referring to the Department's Sales Tax Information Bulletin 60 (July 2006), 20060823 Ind. Reg. 045060287NRA ("Information Bulletin 60"), Taxpayer believed that the Items at Issue qualified as "improvement of real property." Referring to 45 IAC 2.2-3-10(3), Taxpayer further asserted that the charges of the Items at Issue were on a "lump sum" basis, which included labor and materials, and it paid sales tax when it purchased the materials. Thus, Taxpayer maintained that it was not responsible for collecting the sales tax on the Items at Issue.

IC § 6-2.5-1-1(a), in pertinent part, defines:

"Unitary transaction" includes **all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated**. (**Emphasis added**).

45 IAC 2.2-1-1(a) explains:

Unitary Transaction. For purposes of the state gross retail tax and use tax, such taxes shall apply and be computed in respect to each retail unitary transaction. **A unitary transaction shall include all items of property and/or services for which a total combined charge or selling price is computed for payment irrespective of the fact that services which would not otherwise be taxable are included in the charge or selling price**. (**Emphasis added**).

IC § 6-2.5-2-1 provides:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

IC § 6-2.5-4-1, in relevant part, states:

(a) A person is a retail merchant making a retail transaction when he engages in selling at retail.

(b) A person is engaged in selling at retail when, in the ordinary course of his regularly conducted trade or business, he:

(1) acquires tangible personal property for the purpose of resale; and

(2) transfers that property to another person for consideration.

(c) For purposes of determining what constitutes selling at retail, it does not matter whether:

(1) the property is transferred in the same form as when it was acquired;

(2) the property is transferred alone or in conjunction with other property or services; or

(3) the property is transferred conditionally or otherwise.

45 IAC 2.2-4-1 explains:

(a) **Where ownership of tangible personal property is transferred for a consideration, it will be considered a transaction of a retail merchant constituting selling at retail** unless the seller is not acting as a "retail merchant".

(b) All elements of consideration are included in gross retail income subject to tax. Elements of consideration include, but are not limited to:

(1) The price arrived at between purchaser and seller.

(2) Any additional bona fide charges added to or included in such price for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other services performed in respect to or labor charges for work done with respect to such property prior to transfer.

(3) No deduction from gross receipts is permitted for services performed or work done on behalf of the seller prior to transfer of such property at retail.

45 IAC 2.2-4-2 states:

(a) Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:

(1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;

(2) The tangible personal property purchased is used or consumed as a necessary incident to the service;

(3) The price charged for tangible personal property is inconsequential (not to exceed 10 [percent]) compared with the service charge; and

(4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

(b) Services performed or work done in respect to property and performed prior to delivery to be sold by a retail merchant must however, be included in taxable gross receipts of the retail merchant.

(c) **Persons engaging in repair services are servicemen with respect to the services which they render and retail merchants at retail with respect to repair or replacement parts sold**.

(d) **A serviceman occupationally engaged in rendering professional, personal or other services will be presumed to be a retail merchant selling at retail with respect to any tangible personal property sold by him, whether or not the tangible personal property is sold in the course of rendering such services**. If, however, the transaction satisfies the four (4) requirements set forth in 6-2.5-4-1(c)(010), paragraph (1) [subsection (a) of this section], the gross retail tax shall not apply to such transaction. (**Emphasis added**).

Accordingly, Taxpayer is a retail merchant and, therefore, is responsible for collecting and remitting the sales tax.

Also of relevance is 45 IAC 2.2-4-21, which states:

(a) **In general, all sales of tangible personal property are taxable, and all sales of real property are not taxable. The conversion of tangible personal property into realty does not relieve a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property.**

(b) All construction material purchased by a contractor is taxable either at the time of purchase, or if purchased exempt (or otherwise acquired exempt) upon disposition unless the ultimate recipient could have purchased it exempt (see 6-2.5-5 [45 IAC 2.2-5]). (**Emphasis added**).

45 IAC 2.2-3-7, in relevant part, explains:

(a) Contractors. For purposes of this regulation [45 IAC 2.2] "contractor" means any person engaged in converting construction material into realty. The term "contractor" refers to general or prime contractors, subcontractors, and specialty contractors, including but not limited to persons engaged in building, cement work, carpentry, plumbing, heating, electrical work, roofing, wrecking, excavating, plastering, tile and road construction.

(b) Construction material. For purposes of this regulation [45 IAC 2.2], "**construction material" means any tangible personal property to be used for incorporation in or improvement of a facility or structure constituting or becoming part of the land on which such facility or structure is situated**. (**Emphasis added**).

45 IAC 2.2-4-26 further provides:

(a) A person making a contract for the improvement to real estate whereby the material becoming a part of the improvement and the labor are quoted as one price is liable for the payment of sales tax on the purchase price of all material so used.

(b) A person selling tangible personal property to be used as an improvement to real estate may enter into a conpletely [sic] separate contract to furnish the labor to install or construct such improvement, in which case the sales tax shall be collected and remitted by such seller on the materials sold for this purpose. Such sales of materials must be identifiable as a separate transaction from the contract for labor. The fact that the seller subsequently furnished information regarding the charges for labor and material used under a flat bid quotation shall not be considered to constitute separate transactions for labor and material.

(c) Tangible personal property purchased to become a part of an improvement to real estate under a contract with an organization entitled to exemption is eligible for exemption when purchased by the contractor.

The Information Bulletin 60, in pertinent part, further illustrates:

DEFINITIONS

A. "Construction Contractor" means anyone who is obligated under the terms of a contract to furnish the necessary labor or materials, or both, to convert construction material into realty, including a general or prime contractor, a subcontractor, or a special contractor. The term includes a person engaged in the business of building, cement work, carpentry, plumbing, heating and cooling, electrical work, roofing, wrecking, excavating, plastering, tile work, road construction, landscaping, or installing underground sprinkler system.

B. "Construction materials" means **any tangible personal property to be used for incorporation in or improvement of a facility or structure constituting or becoming part of realty**. A "facility" means any additions to the land.

...

E. "**Improvement to real estate**" means that **personal property has been incorporated into and becomes a permanent part of the real property. To accomplish this, the personal property generally takes on an immovable character. An immovable fixture is characterized by three elements:**

(1) Real or constructive annexation of the article in question to the land.

(2) Adaptation of the personal property as part of the land.

(3) The intention of the party making the annexation to make the personal property a permanent part of the land so that it would pass with the land upon a sale.

Examples of installations that constitute improvements to realty are: doors, garage doors, garage door openers, windows, cabinets, garbage disposals, water heaters, water softeners, alarms, furnaces, **central air conditioning units**, gutters, and carpeting.

Examples of installations that do not constitute improvements to realty are: personal computers, home stereos, televisions, refrigerators, stoves, dishwashers, garbage compactors, washers, dryers and window air conditioning units. (**Emphasis added**).

45 IAC 2.2-3-10 further states:

A contractor has no further liability for either the state gross retail tax or use tax with respect to construction material acquired by the contractor in a taxable transaction, provided the contractor disposes of such property in the following manner:

(1) He converts the construction material into realty on land he owns and then sells the improved real estate;

(2) He utilizes the construction material for his own benefit and does not resell or transfer such property to others; or

(3) Lump sum contract. He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price.

At the hearing, Taxpayer asserted that the examples in the Information Bulletin 60 specifically listed that installations of "central air conditioning units" constitute improvements to real estate. Taxpayer thus believed that the example includes installations of "the parts" of the "central air conditioning units" because the heating and cooling system would not function if the broken parts of the system were not removed and replaced with the new parts, which required special knowledge and technical training of Taxpayer's employees. Taxpayer further asserted that Taxpayer's "quotes and pricing were always stated to customers in a lump sum that includes the cost of the labor and the cost of the materials, and that materials and labor were never quoted to the customer separately." Thus, Taxpayer claimed that 45 IAC 2.2-3-10(3) relieved Taxpayer's responsibility of collecting the sales tax on its sales of the Items at Issue because they were "improvement of real property" and were charged on a "lump sum" basis, where Taxpayer paid the sales tax on the materials at the time of the purchases. To support its protest, in addition to copies of the invoices, Taxpayer also submitted a copy of its current pricing schedule and additional documentation to illustrate the Items at Issue.

Taxpayer's reliance is misplaced. The Information Bulletin 60 specifically established three (3) elements for a transaction to be considered as "improvement to real estate" – (1) real or constructive annexation of the article in question to the land; (2) adaptation of the personal property as part of the land; and (3) the intention of the party making the annexation to make the personal property a permanent part of the land so that it would pass with the land upon a sale. The Information Bulletin 60 explains that "[t]o accomplish this, the personal property generally takes on an immovable character." Taxpayer may argue that the Items at Issue it sold were incorporated into real property and were therefore not subject to Indiana sales tax. Even if Taxpayer's argument that the Items at Issue it sold were incorporated into real property is accepted, 45 IAC 2.2-4-21(a) states in relevant part that "the conversion of tangible personal property into realty does not relieve a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property." Therefore, even if the Department accepts Taxpayer's argument that the Items at Issue it sold were then incorporated into real property, the sales of the Items at Issue would still be subject to Indiana sales tax.

The Indiana Supreme Court, in Ind. Dep't of State Revenue v. Trump Ind., 814 N.E.2d 1017 (Ind. 2004), discussed the possible dual characterization of a physical item for different tax purposes:

The same physical item can be transformed from personalty to realty in many contexts. A rudimentary example is that of a fixture bought at a retail store and later installed in a building. The purchaser of the fixture is subject to sales tax (or use tax if bought outside Indiana) because the item is personalty at that point. [. . .] The General Assembly has the power to classify a single piece of property [. . .] first as realty and then as personalty to effectuate independent statutory schemes of taxation. See, e.g., United States Lines, Inc. v. State Bd. of Equalization, 182 Cal. App. 3d 529, 535, 227 Cal. Rptr. 347 (1986) (classification of affixed equipment as realty does not exclude classification of the same equipment as tangible personal property for sales tax purposes).

Id. at 1021.

Accordingly, Taxpayer's sales of the Items at Issue were subject to Indiana sales tax regardless of that, arguably, it subsequently incorporated the Items at Issue into real property.

Additionally, Taxpayer may argue that the charges of the Items at Issue included "the cost of the labor and the cost of the materials" and the labor was a non-taxable service. But, Taxpayer's documentation demonstrated otherwise. Taxpayer's original quotes to its customers and its invoices showed that the charges were separately stated concerning the Items at Issue and services. Even if, for the purposes of the argument, the prices of the Items at Issue included both "the cost of the labor and the cost of the materials," as Taxpayer claimed, Taxpayer did not separate its charges. Thus, the transactions of the Items at Issue fell squarely into the definition of the unitary transactions pursuant to IC § 6-2.5-1-1(a) and 45 IAC 2.2-1-1(a). Thus, Taxpayer is required to collect sales tax on its total charges of the Items at Issue.

Finally, Taxpayer's documentation demonstrated that it paid sales tax on certain materials it purchased and the materials were subsequently sold to its customers. Since Taxpayer purchased the materials for the purposes of reselling the materials, the Department will allow Taxpayer the credits for the sales tax paid at the time of its purchases.

In short, the Department is not able to agree that Taxpayer has met its burden of proof demonstrating that the assessment of the Items at Issue is not correct. Taxpayer, however, demonstrated that it paid the sales tax on the

materials at the time of its purchases. Thus, the Department will give Taxpayer the credits for the sales tax it paid.

B. Trip Charges.

The Department's audit imposed sales tax on the "trip charge" listed in Taxpayer's invoices. Taxpayer asserted that the "trip charge" was a service, not "a delivery fee" and, therefore, was not subject to sales tax.

45 IAC 2.2-4-2 states:

(a) **Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax**. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:

(1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;

(2) The tangible personal property purchased is used or consumed as a necessary incident to the service;

(3) The price charged for tangible personal property is inconsequential (not to exceed 10 [percent]) compared with the service charge; and

(4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

(b) Services performed or work done in respect to property and performed prior to delivery to be sold by a retail merchant must however, be included in taxable gross receipts of the retail merchant.

(c) Persons engaging in repair services are servicemen with respect to the services which they render and retail merchants at retail with respect to repair or replacement parts sold.

(d) A serviceman occupationally engaged in rendering professional, personal or other services will be presumed to be a retail merchant selling at retail with respect to any tangible personal property sold by him, whether or not the tangible personal property is sold in the course of rendering such services. If, however, the transaction satisfies the four (4) requirements set forth in 6-2.5-4-1(c)(010), paragraph (1) [subsection (a) of this section], the gross retail tax shall not apply to such transaction. (**Emphasis added**).

In this instance, Taxpayer explained, in pertinent part, that:

With respect to the trip charges included on the invoices in the sample..., these trip charges are not delivery fees but fees to compensate for the time and skill of [Taxpayer's] technicians who are sent to a customer's site to diagnose and assess problems with their heating and air conditioning systems. The diagnosis and assessment services performed in exchange for these fees may be associated with a job that ultimately involves the installation of materials but that is not the determinative factor. They are also charged when the technician makes a recommendation for service that the customer declines or when the technician performs additional work which involves no materials.... Since trip charges are billed whether materials are involved are not, they do not fit the definition for inclusion in a unitary transaction which hinges on its association with the sale of materials.

Upon reviewing Taxpayer's documentation, it demonstrated that the "trip charges" were separately stated in its invoices and billed to its customers regardless of whether materials were sold to its customers. Thus, Taxpayer has provided sufficient documentation demonstrating that its "trip charges" were the charges for services, and, therefore, not subject to sales tax pursuant to 45 IAC 2.2-4-2(a).

In short, Taxpayer has provided sufficient documentation demonstrating that the "trip charges" were charges for services rendered and, therefore, not subject to sales tax pursuant to the above mentioned statutes and regulations. The Department will remove the assessment of the "trip charges" in a supplemental audit review.

FINDING

Taxpayer's protest is sustained, in part, and respectfully denied, in part. Taxpayer's protest of Part B, the assessment of the "trip charges," is sustained. Taxpayer's protest of Part A, the assessment of the Items at Issue, however, is respectfully denied. Nonetheless, Taxpayer should receive credits for the sales tax it paid at the time of its purchases. The Department will recalculate Taxpayer's tax liabilities in a supplement audit.

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